

E. THE CY PRES DOCTRINE: STATE LAW AND DISSOLUTION OF CHARITIES

1. Introduction

The purpose of this topic is to explain the doctrine of cy pres and to identify the states and circumstances in which the Service will not require an express provision for the distribution of assets upon dissolution in an organization's articles of incorporation, trust instrument, or other organizing document to satisfy the "organizational" test in Reg. 1.501(c)(3)-1(b)(4). Also, this topic provides a sample of an acceptable dissolution provision for organizations that are required to have an express provision for the distribution of assets.

2. Background

Reg. 1.501(c)(3)-1(b)(4) provides that:

Distribution of assets on dissolution. An organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized. However, an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders. [Emphasis added.]

The issue of the applicability of state law (statutory or judicial) in relation to Reg. 1.501(c)(3)-1(b)(4) as to a particular organization only arises where the organization itself has not provided for the distribution of its assets upon

dissolution in its articles of incorporation, organizing document, or trust instrument. When state law satisfies the provisions of Reg. 1.501(c)(3)-1(b)(4), it is not necessary to require an organization to amend its articles of incorporation or organizing document, or to require a trust to obtain a judicial decree amending its trust instrument, in order to satisfy the organizational test for qualification as an exempt organization described in IRC 501(c)(3) where all the other requirements for exemption are met.

The issue of whether Reg. 1.501(c)(3)-1(b)(4) is satisfied under state law can be broken down into three areas according to the type of entity involved:

- (1) cy pres, a common-law doctrine as to testamentary charitable trusts, which can exist in a particular state by case law and/or by statute;
- (2) state corporate law containing statutes that provide for the distribution of assets upon the dissolution of nonprofit corporations; and
- (3) state law by court decision or statute relating to unincorporated associations.

Each of these three types of entities will be treated separately in this discussion. Because there is no guarantee under the law of any of the 51 jurisdictions that cy pres would be used to keep an inter vivos charitable trust from failing any inter vivos charitable trust should be required to have an adequate dissolution provision in its trust instrument to satisfy the requirements of Reg. 1.501(c)(3)-1(b)(4). (Property conveyed by an inter vivos trust is normally transferred during the settlor's lifetime, in contrast to a testamentary trust in which the transfer takes place after the settlor's death based on the provisions of his will. If an inter vivos trust fails, the property intended for transfer reverts back to the settlor.)

The cy pres doctrine is a principle of law that courts use to save a charitable trust from failing when a charitable objective is originally or later becomes impossible or impracticable to fulfill. In such a case, the court may substitute another charitable object which is believed to approach the original charitable purpose as closely as possible. (The term cy pres comes from French law and means "so near" or "as near (as possible).") This legal doctrine is based on the theory that a court has the power to revise a charitable trust where the maker (also called the creator, settlor, or - in the case of a trust under a will - testator) had a

charitable intent in order to meet unexpected emergencies or changes in conditions which threaten the trust's existence.

However, cy pres will not always be applied to save a charitable trust from failing where it is impossible to carry out the particular purposes of the testator. When it appears that the accomplishment of only a particular purpose was desired by the testator and that there was no general intent to benefit charity, the majority of courts will presume that the testator would prefer to have the whole trust fail if the particular purpose is or becomes impossible to accomplish.

In contrast, the majority of courts apply the cy pres doctrine when a testator makes a general bequest for charity, or for general charitable purposes, without specifying a particular purpose or beneficiary. In such a case, the court will choose a particular purpose for the disposition of the property in accordance with the testator's general charitable intent.

The following example demonstrates how a state court might apply the cy pres doctrine to a specific factual situation:

X bequeathed his residuary estate to Hospital A for the benefit of tubercular children. When X died, Hospital A no longer existed and his heirs filed suit claiming that the legacy lapsed and the residuary estate passed to them by intestacy. The court held that the gift to Hospital A was a charitable bequest because the gift was not intended for a particular institution, but for the benefit of tubercular children as a class with the hospital as trustee. Since the purpose and objective for which the trust was created (treatment of tubercular children) still existed, even though the hospital did not, the legacy did not lapse because the cy pres doctrine applied. The court awarded the legacy to another local hospital as trustee for the benefit of tubercular children.

The application of the doctrine of cy pres is subject to change by statute or court decision. We will attempt to update this topic in the future to reflect such changes as they are brought to our attention.

3. Guidelines

a. Charitable Testamentary Trusts.

The courts in the following states always apply the cy pres doctrine or the doctrine of equitable approximation to keep a charitable testamentary trust from failing, and thus Reg. 1.501(c)(3)-1(b)(4) with respect to charitable testamentary trusts is satisfied:

Alabama

Delaware

Louisiana

Pennsylvania

South Dakota

Virginia

West Virginia (However, a state court decision has held that the cy pres doctrine does not apply to a scientific organization in West Virginia.)

The courts in the jurisdictions listed below will apply the cy pres doctrine to keep a charitable testamentary trust from failing when the language of the trust instrument demonstrates that the settlor had a general intent to benefit charity, and not merely a specific intent to benefit a particular institution. In such jurisdictions the cy pres doctrine may be relied upon by a charitable testamentary trust to satisfy Reg. 1.501(c)(3)-1(b)(4) only when the settlor has demonstrated a general charitable intent in the language of the trust instrument. Unless the testator manifests a general intent to benefit charity, the Service will require the charitable testamentary trust to provide an express dissolution provision in the trust instrument to satisfy Reg. 1.501(c)(3)-1(b)(4):

Arkansas

California

Colorado

Connecticut

District of Columbia

Florida

Georgia

Illinois

Indiana

Iowa

Kansas

Kentucky

Maine

Maryland

Massachusetts
Michigan
Minnesota
Mississippi
Missouri
Nebraska
New Hampshire
New Jersey
New York
North Carolina
Ohio
Oklahoma
Oregon
Rhode Island
Tennessee
Texas
Vermont
Washington
Wisconsin

Charitable testamentary trusts in the following states need a dissolution provision in the trust instrument to satisfy Reg. 1.501(c)(3)-1(b)(4) because these states have either expressly rejected or have never applied the cy pres doctrine:

Alaska
Arizona
Hawaii
Idaho
Montana
Nevada
New Mexico
North Dakota
South Carolina
Utah
Wyoming

b. Nonprofit Charitable Corporations.

The statutes applicable to nonprofit charitable corporations in the states listed below will satisfy the provisions of Reg. 1.501(c)(3)-1(b)(4). All other states,

and the District of Columbia do not have statutes applicable to nonprofit charitable corporations that will satisfy the provisions of Reg. 1.501(c)(3)-1(b)(4). Thus, nonprofit corporations in the eight named states do not need a dissolution provision to satisfy Reg. 1.501(c)(3)-1(b)(4). A nonprofit corporation in one of the other jurisdictions not listed needs an adequate dissolution provision in its organizing document to satisfy Reg. 1.501(c)(3)-1(b)(4):

California
Louisiana
Maine
Massachusetts
Minnesota
Missouri
Ohio
Oklahoma

c. Unincorporated Nonprofit Associations.

Unincorporated nonprofit associations are not separate legal entities under state law, unlike a corporation or a trust, and merely constitute a private agreement among individuals to accomplish particular purposes. Consequently, none of the fifty-one jurisdictions provides certainty by statute or case law, for the distribution of assets upon the dissolution of an unincorporated nonprofit association. Therefore, any unincorporated nonprofit association needs an adequate dissolution provision in its organizing document to satisfy the requirements of Reg. 1.501(c)(3)-1(b)(4).

4. Sample Dissolution Provision

For any organization that needs a dissolution provision in its organizing instrument to satisfy the provisions of Reg. 1.501(c)(3)-1(b)(4), the following language is illustrative of what may be used:

Upon the dissolution of [this organization], assets shall be distributed for one or more exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future federal tax code, or shall be distributed to the federal government, or to a state or local government, for a public purpose.